

Application of the public policy ground for 'setting aside' in Turkey

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Although it has been more than ten years since the concept of 'setting aside' became part of Turkish legislation, Turkish courts are still developing their approach to the grounds for setting aside arbitral awards.

Contravention of 'public policy' is the most frequently invoked ground for set aside in Turkey. Unlike other annulment grounds, courts must *ex officio* consider this ground, even if it is not raised by the parties. However, a problem arises from the interpretation of this concept, as there is no definition of public policy in Turkish law. This article examines recent developments in this area.

Guidance from a leading decision in 2012

A decision of the General Assembly for the Unification of Decisions of the Court of Appeals dated 10 February 2012 (the General Assembly Decision) has provided guidance.

This decision examines and explains the concept of public policy and its application, and emphasises its variable nature. According to this decision:

*'It is not possible to say that in the event of breach of every statutory provision or breach of every statutory provision by a foreign decision, there is contradiction with Turkish public policy... the framework of public policy under national law can be drawn as a contradiction with fundamental values of Turkish laws, general Turkish sense of morality, fundamental sense of justice on which Turkish laws are based, general policy on which Turkish laws are based, fundamental rights and freedoms placed in the Constitution, the rules based on common international principles and principle of bona fide under private law, common law principles which are expressions of morality and sense of justice adopted by civil societies, society's level of civilization, political and economic regime, human rights and freedoms.'*¹ [emphasis added]

Despite the guidance provided by this decision, some courts interpret public

policy broadly while others apply a narrower interpretation due to the unclear character of the public policy doctrine. As an example of the broader approach, the Court of Appeals emphasised in one recent decision that public policy is a discretionary concept that cannot be limited.

In contrast, public policy was defined more narrowly in a recent Turkish commercial court decision:

*'There is no conclusive definition of public policy in legislation or doctrine. However, particularly in terms of Turkish International Private Law, it is observed that, in the Court of Appeals' decisions, elements such as contradiction with public morality and customs, incoherence with the fundamental rules and the general policy of Turkish laws are considered as violation of public policy. In order for public policy to come into question, the contradiction with a rule must conflict with one of the fundamental principles of local legal order or severely damage the general sense of law.'*²

With the guidance of the General Assembly Decision, Turkish courts seem to be adopting more arbitration-friendly decisions with a narrower interpretation of public policy. Even so, exceptions to the trend may still be found.

Practical example 1: does a lawsuit for 'cancellation of objection' relate to public policy?

In Turkey, there has been a debate over:

- whether a lawsuit for the cancellation of an objection in terms of the Execution and Bankruptcy Law falls within the scope of public policy; and
- whether an arbitral tribunal is competent to render an award for the cancellation of an objection against execution or bankruptcy proceedings.

As a general rule, when a debtor objects to execution proceedings initiated by a creditor for collection of its receivables, the execution proceedings are automatically suspended.

The creditor must file a lawsuit for the

cancellation of the objection in order for the execution proceedings to continue.

The real problem in arbitral proceedings for the cancellation of objection was related to a specific question: can the arbitral tribunal order 'denial compensation'? Denial compensation is a type of penalty in terms of the Execution and Bankruptcy Law, which is payable (as the case may be) by the losing party. Some scholars opine that it is related to public policy.

Reflecting the guidance of the Court of Appeal's 2012 decision, Turkish courts now accept that cancellation of objection against execution and bankruptcy proceedings is not related to public policy. Therefore, arbitral tribunals can order denial compensation.³

Practical example 2: does an 'excessive' penalty fee violate public policy?

On 12 May 2014, the Court of Appeals overruled a local court's decision rejecting the enforcement of an arbitral award. This decision contains one of the most comprehensive and detailed explanations on public policy, specifically answering the question of whether or not a penalty fee in an agreement between the parties raises an issue of public policy.

The arbitral award, which was to be enforced in Turkey, ordered the Turkish parties – the award debtors – to pay a penalty fee. The penalty fee had been agreed in a previous settlement agreement. The Turkish parties acted and signed the settlement agreement as the guarantors of the monetary obligation of a third party, which was an American affiliate of the Turkish entity involved. The amount of the penalty fee was specified in the settlement agreement as being equal to the total amount that the United States entity undertook to pay under the settlement agreement.

After two-and-a-half years of adjudication, the local court refused to enforce the arbitral award on the ground that the amount of the penalty fee was so excessive as to 'destroy' or 'heavily restrict' the Turkish guarantors' 'financial future'. Accordingly, the local court considered the penalty fee as null and void and refused to enforce the arbitral award, which would violate Turkish public policy.

The award creditor appealed this decision. The Court of Appeals overruled the decision, holding that even if it was accepted that the penalty fee was excessive, the arbitral award should have been enforced, as it was not against public policy:

'It is not possible to accept the local court's reasoning that the penalty fee is excessive and, thus, null and void under Articles 19 and 20 of the abolished Code of Obligations numbered 818 and that this relates to public policy... Even if it is accepted that the penalty fee is excessive, this does not constitute a violation of public policy.'⁴

This decision's application of a strict approach to public policy is a promising development for international arbitration in Turkey.

A contentious issue: state income as a matter of public policy

On 17 April 2012, the Court of Appeals overruled a court's decision refusing to set aside an arbitral award. The Court of Appeals' reasoning was that the execution of the arbitral award would cause a decrease in the Turkish state's income, which would violate public policy.

The Court of Appeals stated that 'decisions that are in violation of laws related to the economic structure of society can also be accepted as a violation of public policy'. It also held that:

'Although the due treasury share and contribution to the Authority's expenses agreed in the agreement are not taxes, they are significant and continuous items of income resulting from the assignment of the public service by the state. In the present case, the exclusion of a discount in wholesales from the gross sales amount... which is the basis for the payment of treasury shares and contribution to the Authority's expenses, *results in a decrease in the treasury shares and contribution to the Authority's expenses*, aiming to provide continuous income. It also disrupts the budget balance. Thus, it is clear that it is going to deteriorate economic balance and is contrary to public policy.'⁵ [emphasis added]

This decision of the Court of Appeals has been heavily criticised. Unlike the General Assembly Decision, which had demonstrated a narrow interpretation of public policy, the latter decision contains an extremely broad interpretation of the concept.

The decision of the 3rd Civil Court of Ankara, dated 21 January 2014, appears to limit the scope of the public policy ground. The court's reasoning in this decision is the exact opposite of the reasoning of the Court of Appeals in its above-mentioned decision.



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The reasoning of the 3rd Civil Court of Ankara is as follows:

‘Resulting in the decrease in public revenue alone cannot be considered as a violation of public policy. Examining the merits of the award is not possible. The request to set the award aside, which seems to decrease public revenue... is not accepted due to lack of legal basis.... Decrease in public revenue is not sufficient alone for such acceptance.’⁶

Unsurprisingly, this decision was appealed by the judgment debtor. Scholars and practitioners are impatiently waiting for the Court of Appeals’ decision. Following the Court of Appeals’ earlier decision, a different outcome in this case would undoubtedly contribute to making Turkey a more arbitration-friendly jurisdiction.

Overall, despite certain potential setbacks

in the evolution of a clear and consistent application of the public policy ground for annulment, Turkish jurisprudence continues to develop on this issue.

Notes

- 1 Decision of the General Assembly for the Unification of Decisions of the Court of Appeals, E. 2010/1, K. 2012/1, dated 10 February 2012
- 2 Decision of the 16th Commercial Court of Istanbul, numbered 2013/157 and dated 20 August 2013
- 3 Decision of the 44th Commercial Court of Istanbul, numbered 2013/268 and dated 19 December 2013
- 4 Decision of the 15th Civil Chamber of the Court of Appeals, E. 2014/2183, K. 2014/3226, dated 12 May 2014
- 5 Decision of the 13th Civil Chamber of the Court of Appeals, E. 2012/8426, K. 2012/10349, dated 17 April 2012
- 6 Decision of the 3rd Civil Court of Ankara, numbered 2013/273 and dated 21 January 2014